No. 1092

In the Supreme Court of the United States

OCTOBER TERM, 1944

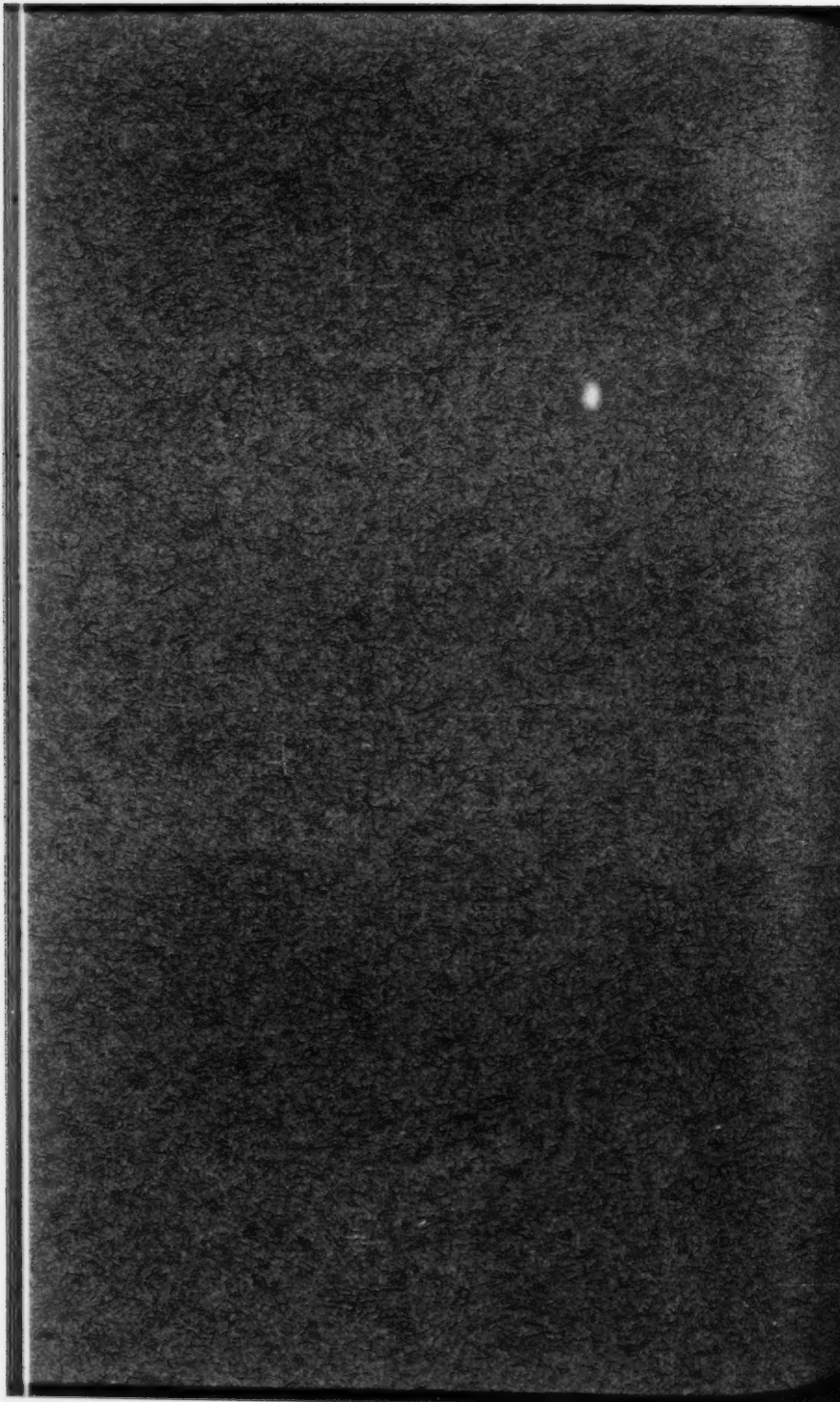
RAYTHEON PRODUCTION CORPORATION,

Petitioner,

v.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIRST CIRCUIT

BRIEF FOR [illegible]



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In the Supreme Court of the United States

OCTOBER TERM, 1944

No. 609

RAYTHEON PRODUCTION CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIRST CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 16–31) are reported in 1 T. C. 952. The opinion of the Circuit Court of Appeals (R. 139–147) is reported in 144 F. 2d 110.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on July 28, 1944 (R. 147). The petition for a writ of certiorari was filed on October 18, 1944. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

A lump sum payment was made to the taxpayer in compromise of a suit for damages allegedly resulting from violation of the federal antitrust laws and the taxpayer failed to show the cost or other basis of its good will which had been destroyed. The question is whether the entire compromise payment is taxable income.

STATUTE INVOLVED

The pertinent statutory provisions are printed in the Appendix, *infra*, pp. 11–12.

STATEMENT

The facts as found by the Tax Court (R. 17–25) may be summarized as follows:

The taxpayer, Raytheon Production Corporation, came into existence as a result of a series of tax-free reorganizations which are not here involved. The original and successor companies will be referred to as "Raytheon". The original Raytheon Company was a pioneer manufacturer of a rectifying tube which made possible the operation of a radio receiving set on alternating current instead of on batteries. In 1926 its profits were about $450,000; in 1927 about $150,000; and in 1928, $10,000. (R. 17.)

The Radio Corporation of America (hereinafter termed R. C. A.) had many patents covering radio circuits and claimed control over almost all of the

practical circuits. Cross-licensing agreements had been made among several companies including R. C. A., General Electric Company, Westinghouse, and American Telephone & Telegraph Company. R. C. A. had developed a competitive tube which produced the same type of rectification as the Raytheon tube. Early in 1927, R. C. A. began to license manufacturers of radio sets, and in the license agreement it incorporated "Clause 9", which provided that the licensee was required to buy its tubes from R. C. A. In 1928 practically all manufacturers were operating under R. C. A. licenses. As a consequence of this restriction, Raytheon was left with only replacement sales, which soon disappeared. (R. 17–18.)

When Raytheon found it impossible to market its tubes in the early part of 1929, it obtained a license from R. C. A. to manufacture tubes under the latter's patent on a royalty basis. The license agreement contained a release of all claims of Raytheon against R. C. A. by reason of the illegal acts of the latter under Clause 9, but by a side agreement such claims could be asserted if R. C. A. should pay similar claims to others. The taxpayer was informed of instances in which R. C. A. had settled claims against it based on Clause 9. On that ground it considered itself released from the agreement not to enforce its claim against R. C. A. and consequently, on December 14, 1931, the taxpayer caused its predecessor, Raytheon, to

bring suit against R. C. A. in the United States District Court for the District of Massachusetts alleging that the plaintiff had by 1926 created and then possessed a large and valuable good will in interstate commerce in rectifying tubes for radios and had a large and profitable established business therein so that the net profit for the year 1926 was $454,935; that the business had an established prospect of large increases and that the business and good will thereof were of a value exceeding $3,000,000; that by the beginning of 1927 the plaintiff was doing approximately 80 per cent of the business in rectifying tubes of the entire United States; that the defendant conspired to destroy the business of the plaintiff and others by a monopoly of such business and did suppress and destroy the existing companies; that the manufacturers of radio sets and others ceased to purchase tubes from the plaintiffs; that by the end of 1927 the conspiracy had completely destroyed the profitable business and that by the early part of 1928 the tube business of the plaintiff and its property and good will had been totally destroyed at a time when it had a present value in excess of $3,000,000, and thereby the plaintiff was injured in its business and property in a sum in excess of $3,000,000. (R. 19–20.)

The action against R. C. A. was referred to an auditor who filed a report on February 14, 1938. He found that Clause 9 was not the cause of dam-

age to the plaintiff but that the decline in plaintiff's business was due to advancement in the radio art and competition. (R. 20–21.) The auditor also found that if the plaintiff was entitled to recovery by reason of Clause 9 the damages were estimated at $1,000,000 (R. 141).

In the spring of 1938, after the auditor's report and just prior to the time for the commencement of the trial before a jury, the Raytheon affiliated companies began negotiations for the settlement of the litigation with R. C. A. In the meantime, a suit brought by R. C. A. against the taxpayer for the non-payment of royalties resulted in a judgment of $410,000 in favor of R. C. A. R. C. A. and the taxpayer finally agreed on the payment by R. C. A. of $410,000 in settlement of the antitrust action. (R. 21.) A written plan of settlement was carried out under the terms of which mutual releases of any claims against the other were executed and Raytheon granted to R. C. A. certain patent license rights and sublicensing rights to a group of patents. R. C. A. declined to allocate the amount paid as between the patent license rights and the amount for the settlement of the suit. (R. 21–23.) Officials of the Raytheon companies ascribed $60,000 of the $410,000 to the value of the patents and allocated $350,000 as a credit to surplus (R. 24).

In its income tax return for the fiscal year 1938, the taxpayer treated the $350,000 as a realization

from a chose in action and not as taxable income. The Commissioner determined that the $350,000 constituted income. (R. 24.) The Tax Court sustained the Commissioner (R. 16) and the Circuit Court of Appeals affirmed (R. 147).

ARGUMENT

This case involves the question of what part of a lump sum settlement received in compromise of litigation can be ascribed to a replacement of capital and what part to income. That is a factual question for determination by the Tax Court. *Helvering* v. *Nat. Grocery Co.*, 304 U. S. 282, 294; *Wilmington Co.* v. *Helvering*, 316 U. S. 164, 168; *Dobson* v. *Commissioner*, 320 U. S. 489. Apportionment, between claims for undermaintenance (a capital item) and for additional compensation (taxable income), of a lump sum settlement received by a railroad from the Director General of Railroads was held to be purely a fact question in *Southern Ry. Co.* v. *Commissioner*, 74 F. 2d 887, 893 (C. C. A. 4th). The facts there are strikingly similar to the instant case since no apportionment of the fund was made by the Director General. The burden of proof, in the instant case, to show what part of the payment by R. C. A. was a replacement of capital, rested upon the taxpayer and in that it failed. *Equitable Society* v. *Commissioner*, 321 U. S. 560, 563–564; *Burnet* v. *Houston*, 283 U. S. 223, 227–228.

It is immaterial whether the transfers of assets between the various companies were tax-free reorganizations or not. If we assume that they were, then the taxpayer must show the cost of the good will, alleged to have been destroyed, of Raytheon, the predecessor owner.[1] If not, the taxpayer must show its own cost for the claim or chose in action. No value was ascribed to the claim as such in any of the tax-free transfers from company to company. There is no proof of cost to any of the various corporate holders including the taxpayer. A replacement of capital loss is tax free only above the basis of cost. *Detroit Edison Co.* v. *Commissioner,* 319 U. S. 98, 101–102. Damages received for property seized under condemnation present a clear analogy. In such cases capital cost may be recovered tax free but any amount received above the cost basis results in taxable income. *Kieselbach* v. *Commissioner,* 317 U. S. 399, 404–405. And compensatory damages paid as the result of a suit for breach of warranty were held taxable as income in *Burnet* v. *Sanford & Brooks Co.,* 282 U. S. 359.

The Tax Court held that the cost or other basis of Raytheon's good will and business was not shown and that therefore the amount of any nontaxable capital recovery could not be ascertained

[1] Since the taxpayer retained its physical assets, the cost basis of good will and the cost of developing its rectifier tube are the only capital items involved.

(R. 29). A similar situation existed in *Sterling* v. *Commissioner,* 93 F. 2d 304, 306 (C. C. A. 2d), certiorari denied, 303 U. S. 663, where the taxpayer failed to prove the March 1, 1913, value of her claim to an interest in real estate and was therefore taxed on the entire amount received in a compromise settlement of her claim.

The Circuit Court of Appeals held that compensation for the loss of Raytheon's good will in excess of its cost would be gross income and that "the record is devoid of evidence as to the amount of that basis" (R. 146). There is present here a total failure of proof which is fatal to the taxpayer's contention of a tax-exempt capital replacement. It cannot be said on this record that $350,000, a figure arbitrarily fixed by interested officers of the taxpayer, represented a capital replacement.

The contention that damages for injury to an intangible capital asset can never be income (Pet. 7, 10–12) is not supported by the cases cited. *Bowers* v. *Kerbaugh-Empire Co.,* 271 U. S. 170, 172, involved a situation where the excess of losses of the taxpayer over income was more than the amount claimed by the Government to have been taxable as income in 1921. The question was whether the difference between the value of marks measured by dollars at the time of repayment of a loan and the value when the loans were made was income. The facts showed continuous losses

in 1913 to 1918 and this Court said (271 U. S. at p. 175): "The result of the whole transaction was a loss". Cf. *Burnet* v. *Sanford & Brooks Co.*, 282 U. S. 359.

While this Court in *United States* v. *Safety Car Heating Co.*, 297 U. S. 88, 98, referred to an injury to capital as not resulting in income, the facts in that case show that the recovery was less than the March 1, 1913, value. The dictum relied on by the taxpayer (Pet. 11–12) cannot be given the effect of overruling the well-established doctrine that capital gains constitute taxable income.

We do not find a conflict among the decisions of the Circuit Courts of Appeals as contended (Pet. 7, 9–10). As pointed out by the Circuit Court of Appeals (R. 146–147) in *Farmers' & Merchants' Bank* v. *Commissioner*, 59 F. 2d 912 (C. C. A. 6th), the plaintiff's bank business was injured and the compensation paid was to recoup for the injury. The court's reasoning merely deals with the nature of the recovery and it assumes that since the recovery was not for lost profits, it did not constitute income. It may not be interpreted as a clear holding that a recovery of capital is not income even though in excess of the basis. See *Davis* v. *Commissioner*, 35 B. T. A. 1001, 1013–1015.

Central R. Co. v. *Commissioner*, 79 F. 2d 697 (C. C. A. 3d), involved the question whether the amounts realized through impressing a trust upon

the earnings of a fiduciary could properly be treated as income of the *cestui*. The court held (79 F. 2d at p. 699) that the amount received was not income of the railroad but a penalty imposed by law on a faithless fiduciary named Joyce for double dealing. The *ultra vires* operations of the fiduciary were not carried on by the use of the capital and labor of the railroad but were separate and apart from the latter's business structure.

Both of the above cases are discussed in *Sterling* v. *Commissioner*, 93 F. 2d 304, 306 (C. C. A. 2d), in which this Court denied a petition for certiorari, 303 U. S. 663.

CONCLUSION

The decision below is correct. There is no conflict of decisions and the petition for certiorari should be denied.

Respectfully submitted.

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